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SUBJECT: PARTY OF REGIONS REACTS TO GAS DEAL

Classified By: Ambassador William Taylor for reasons 1.4 (b,d).

SUMMARY

11. (C) Party of Regions shadow Fuel and Energy Minister Yuriy Boyko publicly called the recent gas deal between Ukraine and Russia "a betrayal of national interests." Regions MPs believe the economics of the deal favor Russia and will be a blow to Ukrainian industry. They dismissed the removal of shadowy gas intermediary RosUkrEnergo (RUE) as a public relations move designed to help Prime Minister Tymoshenko in the upcoming presidential election. The exclusion of RUE from the deal may diminish the influence of RUE head Firtash as a financier of Regions, helping some factions in the party which were at odds with him, and diminishing RUE's influence on decision making. END SUMMARY.

"SHAMEFUL DEFEAT"

12. (SBU) The Party of Regions publicly condemned Prime Minister Tymoshenko's January 19 gas deal with Russia. Regions shadow Fuel and Energy Minister Yuriy Boyko called the deal "a betrayal of national interests." In an official announcement, the party said that Ukraine suffered a "shameful defeat" in gas negotiations with Russia and that the new ten-year contract would bring Ukraine "poverty, starvation, cold, and lost hopes." The statement also alleges that Prime Minister Tymoshenko will benefit personally under the new contract.

ECONOMICS DON'T MAKE SENSE

13. (C) Party of Regions MP and shadow Economics Minister Irina Akimova outlined to us Regions' three major criticisms of the gas deal. First, the "European" 450 USD price per thousand cubic meters (tcm), from which a twenty percent discount for 2009 is calculated, was not based on true current European gas prices. She claimed that if you remove transit costs paid by Western European countries, the true price for gas is closer to 320 to 350 USD per tcm.

14. (C) Second, Prime Minister Tymoshenko failed to raise the transit price for Russian gas exported across Ukraine until 12010. If Ukraine is going to pay European gas prices with a twenty percent discount for 2009, then Gazprom should pay European transit prices calculated with a similar discount. Third, the payment conditions for Ukraine under the new contract are very unfavorable. Akimova claimed that if at any time Ukraine pays Gazprom late, then the contract shifts to 100 percent prepayment prior to gas delivery. She said that no other Gazprom customer has such draconian payment requirements and it was inevitable that Ukraine would be forced into prepayment.

15. (C) Regions MP and deputy faction leader Volodymyr Makeienko told us that sharply higher gas prices will be a serious blow to industry across Ukraine, especially the gas intensive metals and chemical sectors, who are already grappling with sharply lower demand and falling world prices. He said that because of higher gas prices, a number of enterprises will be closed that might otherwise have weathered the current economic downturn.

RUE REMOVAL IS A HOLLOW VICTORY

16. (C) Akimova dismissed the removal of shadowy gas intermediary RosUkrEnergo (RUE) as more a public relations stunt than a blow to corruption in Ukraine. Now Tymoshenko can claim that she is serious about fighting corruption without truly addressing its root causes. Akimova said that Regions was more interested in the price of gas for industry and the population than how it was delivered. Akimova said that given Ukraine's endemic corruption it is foolish to think that removing RUE will have a major impact on corruption in the energy sphere. She said that major steps need to be taken to reduce corruption in Ukraine, but if removing RUE meant an almost doubling of the gas price for Ukraine, then it came at too high a price.

ONLY EUROPE WON IN THE GAS WAR

17. (C) MP Makeienko told us that the gas cutoff to Europe will end up costing Ukraine more than Russia. He said that both countries unprofessional actions reinforced media stereotypes about instability and corruption in Ukraine and Russia. However, Ukraine will struggle more than Russia to overcome investor concerns in the near-term, because it lacks the size and important natural resources that make Russia impossible to ignore.

18. (C) Russia and Ukraine both lost the gas war, according to Akimova. She said that Europe shrugged off the 2006 gas dispute as an anomaly, but now they know that Russia is not a reliable supplier and Ukraine is not a reliable transit state. Akimova said her contacts in Europe did not believe that the current ten-year contract would last and that repeat gas cutoffs were inevitable. She said that both Ukraine and Russia acted irrationally and let emotions stand in the way of business.

19. (C) Akimova said that in the long-term only Europe wins from the gas war. There will be a turn away from reliance on Russian gas pipelines and a renewed effort to build liquefied natural gas terminals. Akimova speculated that alternative pipeline projects from the Caspian bypassing both Russia and Ukraine, or from North Africa would also gain new interest. Finally, the gas shutoff strengthened European supporters of renewable and nuclear energy.

FIRTASH'S INFLUENCE IN THE PARTY MAY WANE

110. (C) Regions MP Nestor Shufrych, personally close to Tymoshenko, welcomed RUE's exclusion from the most recent gas agreement and told us that without revenue from RUE, Ukrainian businessman Dmitro Firtash's influence in the Party of Regions would fade. Makeienko, who describes himself as a part of former Prime Minister and party head Viktor Yanukovych's faction within Regions, said that Firtash had alienated many Regions MPs as he tried to buy their loyalty. He said that Firtash's influence is an irritant in the party because Firtash's interests often conflict with the more traditional business oriented faction under Ukrainian oligarch Rinat Akhmetov. Akimova, the former head of Akhmetov's think-tank, the Bureau for Economic and Social Technologies, said that she would welcome Firtash's marginalization within the party. She said Firtash's

long-term commitment to the party is unclear and that Regions did not need people who allied with the party just for tactical advantages.

COMMENT

¶11. (C) Regions is not a monolith. The blow to Firtash and RUE is clearly welcome to some in the party. Others, such as Yanukovich, will need to find new sponsorship if Firtash pulls back financial support. On one thing they can all agree: the shift to market pricing for gas will put further pressure on already beleaguered heavy industry in Regions' key constituencies in Eastern and Southern Ukraine.

TAYLOR